JOINT APPLICATION OF
USGen NEW ENGLAND, INC.
NEW ENGLAND POWER COMPANY
MASSACHUSETTS ELECTRIC COMPANY AND
NANTUCKET ELECTRIC COMPANY

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USGen NEW ENGLAND, INC.
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JOINT APPLICATION OF
USGen NEW ENGLAND, INC.
NEW ENGLAND POWER COMPANY
MASSACHUSETTS ELECTRIC COMPANY AND
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COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

USGEN NEW ENGLAND, INC.)DOCKET NO. _________
NEW ENGLAND POWER COMPANY)
MASSACHUSETTS ELECTRIC COMPANY)
NANTUCKET ELECTRIC COMPANY)

DIRECT TESTIMONY

OF

JENNIFER L. KENNEY

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

USGEN NEW ENGLAND, INC.)DOCKET NO. ________
NEW ENGLAND POWER COMPANY)
MASSACHUSETTS ELECTRIC COMPANY)
NANTUCKET ELECTRIC COMPANY)

DIRECT TESTIMONY

OF

JENNIFER L. KENNEY

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QUALIFICATIONS

Q.Please state your name and business address.

A.My name is Jennifer L. Kenney. My business address is 25 Research Drive, Westborough, Massachusetts 01582.

Q.By whom are you employed and in what capacity?

A.I am a Principal Financial Analyst for New England Power Service Company (NEPSCO). NEPSCO provides legal, engineering, and other professional services for the utility subsidiaries of the New England Electric System (NEES), a registered public utility holding company system, which includes New England Power Company (NEP), Massachusetts Electric Company, Nantucket Electric Company (together, Mass. Electric), The Narragansett Electric Company (Narragansett) and Granite State Electric Company, and NEPSCO.

Q.Please briefly summarize your educational and professional background.

A.I have earned a Bachelor of Arts degree in Management Science from Westminster College and a Masters of Science in Finance from Boston College. I joined NEPSCO in 1987 as an assistant financial analyst and have been promoted several times within the Corporate Finance Department, most recently to Principal Financial Analyst. My responsibilities currently include calculation of Contract Termination Charges and a variety of other financial services to NEES subsidiaries.

Q.Have you previously testified before this Commission or any other?

A.Yes. I have testified before this Commission in a financing proceeding. I filed written testimony with the Federal Energy Regulatory Commission (FERC) on April 24, 1997 in Docket Nos. ER97-678-000 and ER97-680-000. I have also testified in a stranded cost proceeding before the New Hampshire Public Utilities Commission and in financing proceedings before the Rhode Island Public Utilities Commission.

PURPOSE OF TESTIMONY

Q.What is the purpose of your testimony?

A.My testimony will describe the impact of the divestiture of NEP’s fossil and hydro generating units (Divestiture) on the Mass. Electric Contract Termination Charge. The Contract Termination Charge is the charge that NEP proposes to collect from Mass. Electric pursuant to a settlement agreement filed with this Commission on May 28, 1997 in Docket No. 96-25 (the Settlement), in exchange for NEP's release of Mass. Electric from its all-requirements contractual obligation under NEP's FERC Electric Tariff, Original Volume No. 1 (Tariff No. 1). The Contract Termination Charge recovers the above-market costs of the investments and obligations that NEP has undertaken to provide service to Mass. Electric under its Tariff No. 1 service agreement. These costs fall into four categories of commitments: (I) generation-related commitments, including natural gas conversion costs and above-market pipeline demand charges; (ii) regulatory assets; (iii) nuclear obligations including decommissioning costs and nuclear costs independent of operation; and (iv) above- market payments to power suppliers for purchased power contracts. The formula for the calculation of the Contract Termination Charge segregates the specific costs associated with these four categories of commitments into Fixed and Variable Components, with the Fixed Component being credited with the net proceeds realized upon the divestiture of NEP's generating business and related assets, and the Variable Component adjusted for the assumption of any other obligations as a result of Divestiture.

Q.Please describe the anticipated impact of Divestiture on the Mass Electric Contract Termination Charge?

A.Divestiture will reduce the Total Contract Termination Charge, including both the Fixed and Variable Components, to about 50 percent of the amounts included in the original Settlement, as calculated on a present value basis. As explained by Mr. Zschokke and shown in Exhibit PTZ-1, assuming retail access is broadly available in New England, the

Settlement and Residual Value Credit produce an 18 percent overall reduction in average retail rates.

A more effective implementation of the Residual Value Credit following divestiture requires a modification of the formula that was reflected in the NEP wholesale Settlement to shorten the amortization of Fixed Component cost recovery, including Residual Value Credit, to the period between the Divestiture Date and December 31, 2000, rather than through 2009 as initially reflected in the Settlement and to change the baseline assumptions for several of the Variable Components. My testimony illustrates these adjustments which NEP reserved the right to make in the May 1997 Settlement. The revised formula and schedules that NEP proposes to implement are included as Exhibit JLK-6 to my testimony. These amendments are intended to become effective on the Divestiture Date and to supersede the schedules included in the Wholesale Settlement at that time. The 2.8 cent per kilowatthour Termination Charges under the retail rates that were filed with the Commission in Docket No. 96-25 will be charged in Massachusetts after Retail Access commences. These charges will be superseded by the lower charges in Exhibit JLK-6 on the Divestiture Date under NEP's proposal contained herein.

MAY 1997 SETTLEMENT PROVISIONS

Q.Please describe how the results of Divestiture would flow through the Contract Termination Charge as specified in the May 1997 Settlement if the changes that NEP is proposing were not implemented?

A.As stipulated in the May 1997 Settlement, the Contract Termination Charge formula includes provisions for reflecting the impact of NEP's divestiture in the Contract Termination Charge. First, the Contract Termination Charge formula provides for a credit to the Fixed Component, called a Residual Value Credit, which reduces the Fixed Component in equal annual amounts through 2009 (approximately 12 years), in recognition of the proceeds NEP will receive from Divestiture. Second, the Contract Termination Charge formula also includes a Reconciliation Account which accumulates any differences between estimated Variable Component costs and Actual Variable Component costs, related to Divestiture and otherwise, and adjusts the Contract Termination Charge accordingly commencing in 2001 and annually thereafter.

Q.What is the impact on the Contract Termination Charge of adjustments made pursuant to these provisions in the May 1997 Settlement?

A.As shown in Exhibit JLK-1 the Contract Termination Charge is reduced to between approximately 1.9 cents per kilowatthour from the pre-Divestiture amount of 2.80 cents per kilowatthour through year end 2000, due to the Residual Value Credit. Upon implementation in 2001 of the adjustments due to Reconciliation Account accumulations resulting from the assumption of various contractual obligations assumed by USGen New England, Inc. ("USGenNE") that reduce the anticipated actual Variable Component costs, the Contract Termination Charge is further reduced to approximately 1.3 cents per kilowatthour in that year. The Contract Termination Charge fluctuates thereafter between .9 cents per kilowatthour and -.2 cents per kilowatthour.

CONTRACT TERMINATION CHARGE ADJUSTMENTS

Q.Within the provisions of the May 1997 Settlement, is there a way to produce a more stable and declining Contract Termination Charge?

A.Yes. The Contract Termination Charge includes a provision which would allow for the immediate recognition of reduced Variable Component costs as a result of Divestiture as well as a change in the amortization of Fixed Component items. Specifically, in Footnote 9 on page 55 of the Mass. Electric Settlement the formula states that "the Buyer may assume other obligations that are included in the Variable Component of the Contract Termination Charge. NEP reserves the right to revise the variable cost estimates and the amortization of the fixed cost components in Schedule 1 to reflect the assignment of obligations to the purchasers, if such revision is necessary to maintain a stable and declining pattern of Contract Termination Charges as offset by the Residual Value Credit."

As part of NEP's divestiture, USGenNE is assuming contractual obligations of NEP under various purchased power and fuel transportation contracts, the above-market costs of which were included in the Variable Component. Because the "buyout" payments NEP will be required to make in conjunction with USGenNE's assumption of obligations, if any, are lower than the related estimate of above-market costs included in the Contract Termination Charge, it is beneficial to simply replace the previous estimates, rather than true-up to actual later. Also, the amortization of the Fixed Component, including Residual Value Credit, can be shortened to a period less than the approximately twelve year period contemplated in the original Settlement without necessarily accelerating recovery of the post-Divestiture Fixed Component. In addition, NEP has modified the formula to retain the unamortized investment tax credits associated with the divested facilities. The investment tax credit associated with NEP's nuclear entitlements continues to be amortized through the formula. Adjustments to both the Variable and Fixed Components pursuant to this provision produce annual Contract Termination Charges that are lower in the initial years of, and remain more stable throughout, the transition period than the annual Contract Termination Charges that would result from simply reflecting the results of Divestiture without implementing the adjustments in this specific provision. Please compare Exhibit JLK-1 to Exhibit JLK-2. The adjustments in this provision are implemented via the revised Contract Termination Charge Formula attached and marked to show changes as Exhibit JLK-4, which take effect only upon Divestiture. Both the revised formula and proposed schedules are also included in Exhibit JLK-6.

Q.What is the benefit of changing the amortization period of the Fixed Component to conclude in the year 2000?

A.The change in the amortization period of the Fixed Component stems from the fact that the provisions of the May 1997 Settlement for amortization of the Fixed Component and Residual Value Credit effectively collected the entire Post- Divestiture unamortized Fixed Component in less than 3 years anyway, assuming Total Proceeds equal $1.59B. Essentially, within the first 3 years the annual amortization of the base Fixed Component exceeded the annual amortization of Net Proceeds included in the Residual Value Credit by enough that, on a net basis, the entire amount of post-Divestiture Fixed Component costs were completely collected. The fact that the net Fixed Component costs would be completely recovered by year end 2000 means that the amortization collected in 2001 through 2004 would simply be collected only to be returned to customers through the amortization in the Residual Value Credit in 2005 through 2009. The annual amortization of the Fixed Component in 2005 through 2009 of the original amortization period was more than offset by the back-end loaded credit of amortization of Net Proceeds that is inherent in the Residual Value Credit. As shown on Exhibit JLK-1, the Fixed Component actually becomes negative in the later years using the amortization period through 2009 included in the formula in the original Settlement. Please refer to Exhibit JLK-5 for comparison of the amortization through 2000 and the amortization through 2009 and the impacts on the Contract Termination Charge.

Because all of the generation related costs were effectively collected in less than 3 years regardless, it is sensible and beneficial to shorten the amortization to eliminate the situation where the Contract Termination Charge over recovers for a few years simply to return the over-recovery at a later date.

Q.Please describe in detail the adjustments to the Fixed Component and Variable Component to reflect the results of Divestiture.

A.I will describe the purpose and method for calculating the Residual Value Credit as well as the updated estimated Variable Component costs which reflect Divestiture.

RESIDUAL VALUE CREDIT

Q.Please explain the purpose of the Residual Value Credit.

A.The Residual Value Credit is the mechanism by which the Fixed Component is adjusted to reflect the proceeds that NEP will realize through Divestiture. The Residual Value Credit credits the Fixed Component with the proceeds paid to NEP by USGenNE, net of certain costs incurred by NEP as a result of Divestiture (Net Proceeds), in equal annual amounts. The effect of crediting the Residual Value Credit to the Fixed Component is that the resulting Contract Termination Charge collects only those unrecovered sunk generating plant and regulatory asset costs not recovered through the proceeds of Divestiture.

Q.When will the Residual Value Credit be implemented?

A.The Residual Value Credit included in the revised schedules in Exhibit JLK-6 will become effective on the Divestiture Date, which is assumed to be July 1, 1998 in the exhibits. Should the Divestiture Date occur earlier or later, the revised schedules, consistent with the formula, will be implemented at such time. This approach allows NEP to reduce the Contract Termination Charge immediately upon the Divestiture Date. The Divestiture is subject to many regulatory approvals, including the approval of this Commission, and the closing date may vary depending on the timing of the approvals. Accordingly, the Fixed Component balances unrecovered as of the Divestiture date will be adjusted when the actual sale date is known. Specifically, the formula provides for a reconciliation within 90 days of the closing. Under the amendment, the reconciliation is also subject to later adjustment and true-up.

Q.What are the proceeds that result from Divestiture?

A.USGenNE will pay NEP $1.59 billion (Total Proceeds), an amount which is 45% above the net book value of the assets which is included in the Contract Termination Charge, on the Divestiture Date assuming that retail choice is broadly available in New England. For purposes of my testimony I assume that the Retail Access Date, Contract Termination Date, and Divestiture Date occur simultaneously on July 1, 1998 in Massachusetts. However, in the event that retail choice is not broadly available in New England as of the assumed Divestiture date, $225 million of the Total Proceeds will be held back (the Holdback). If retail choice subsequently follows, NEP will receive the additional proceeds at such time which will generate an additional Residual Value Credit, in amounts specified in the Asset Purchase Agreement. Essentially, if retail access occurs prior to January 1, 1999 the additional proceeds to be realized are $225 million, and decline ratably upon dates thereafter. Please see the testimony of Mr. Jesanis for a detailed description of the Holdback provision. For purposes of comparison, I have also addressed in Exhibit JLK-3 the impact on the Residual Value Credit, and ultimately the Contract Termination Charge for Mass. Electric, assuming that no additional proceeds are ever realized because retail choice never occurs.

Q.Is the entire amount of Total Proceeds included in the calculation of the Residual Value Credit?

A.Yes, however, NEP will incur certain costs related to Divestiture which are not included in the estimates of the base Fixed or Variable Components that it will recover from the Total Proceeds. The reimbursement to NEP for these costs will produce an adjusted amount of proceeds (Net Proceeds) to be credited through the Residual Value Credit. Specifically, under the proposed amendments, NEP will recover (I) its investment in NERC stock, (ii) capital expenditures made after 1995 that contribute to the value of the plants USGenNE is purchasing, (iii) transaction costs, including legal and financial fees, in excess of $20 million, and (iv) lost revenue during the period from Retail Access to the Divestiture Date.

Q.Please describe the reimbursement for the investment in NERC stock.

A.USGenNE is purchasing from NEP its 20% equity ownership interest in OSP Units I and II. NEES will transfer its equity interest in its subsidiary Narragansett Energy Resources Company (NERC), which currently owns the interest in OSP Units I and II, to NEP and make a capital contribution to NEP in an amount equal to NERC's stock at book value. The purchase of the equity interest in OSP Units I and II by a buyer was not previously contemplated at the time of the original Settlement, nor was the cost of the OSP ownership interest included in the Contract Termination Charge. The exclusion of the book value of the stock from the original Contract Termination Charge warrants its exclusion from the Residual Value Credit. The book value of NERC's stock is estimated to be approximately $32 million at July 1, 1998 as shown on Schedule 6, Page 1, Line 3 of Exhibits JLK-1 through JLK-3.

Q.Were the other adjustments that reduce Total Proceeds included in the original Settlement?

A. Yes. Reductions for capital expenditures made after December 31, 1995 and prior to the Divestiture Date, reasonable transactions costs related to Divestiture, and lost revenue were specifically identified in the original Settlement. However, in the amendment NEP is proposing to limit its recovery of transaction costs to only the amount that exceeds $20 million.

Q.Please quantify each of the other adjustments to Total Proceeds.

A.From the end of 1995, through the Divestiture Date, fossil and hydro capital expenditures are estimated to be approximately $28 million. The $28 million excludes the specific capital expenditures for which USGenNE will reimburse NEP directly. Transaction costs are assumed to be approximately $50 million, of which only $30 million are included as an offset to the total proceeds. Lost revenue has not been estimated and is assumed to be zero. Please refer to Schedule 6, Page 1, Lines 4 through 7 on Exhibits JLK-1 through JLK-3.

Q.Based upon these adjustments, what is your estimate of Net Proceeds?

A.Mass. Electric is allocated its 72.6% share of NEP's $1.59 billion Total Proceeds, adjusted for Divestiture related costs, to arrive at Net Proceeds for purposes of Residual Value Credit.

As shown on Exhibits JLK-2 and JLK-6, Schedule 6(a), Page 1, Mass Electric's share of Total Proceeds equals $1.154 billion. Mass Electric's share of the reimbursement for NEP's purchase of NERC stock is estimated to be $23 million, capital investment since December 31, 1995 is estimated to be $20 million, and reasonable transaction costs is estimated to be $22 million. As mentioned above, lost revenue is assumed to be zero. As a result, Net Proceeds for Mass Electric's Residual Value Credit are estimated to be $1.089 billion. As explained below, these estimates are subject to a final reconciliation 90 days after closing.

As explained below, these estimates are subject to a final reconciliation 90 days after closing.

Q.How are Net Proceeds converted into a Residual Value Credit?

A.Pursuant to the Settlement, the Residual Value Credit is calculated so that it credits the Fixed Component in equal monthly amounts which are comprised of a combination of the principal amount of the Net Proceeds amortized over the period of the Residual Value Credit, and return on the unamortized balance of Net Proceeds over the same period. The calculation of the Residual Value Credit is similar to that of a mortgage payment that includes principal and interest which sum to the same total each period.

Q.What is the amortization period of the Residual Value Credit?

A.The Net Proceeds will be amortized through the Residual Value Credit from the Divestiture Date through December 31, 2000, which is the same as amortization of the Fixed Component.

Q.What is the rate of return on the Residual Value Credit?

A.The rate of return on the Residual Value Credit is the same as the rate of return on the Fixed Component. In the Mass. Electric Settlement the overall pre-tax return is 11.18%.

Q.Will there be any reconciliations to the Residual Value Credit?

A.Yes. Items such as capital expenditures, transaction costs, and lost revenue will not be known with certainty on the Divestiture Date and will require a reconciliation to actual. Within 90 days of the Divestiture Date, NEP will reconcile the estimates included in the Residual Value Credit that it implemented on the Divestiture Date to reflect the actual results of the Divestiture. Any reconciliation necessary will flow through the Reconciliation Account and be treated consistently with other Reconciliation Account adjustments.

Q.Please quantify the ultimate impact of the Residual Value Credit on the Contract Termination Charge.

A.The Residual Value Credit alone reduces the Contract Termination Charge by approximately 30% over the period, as calculated on a net present value basis. As explained below, USGenNE will also assume ongoing obligations included in the Variable Component of the Contract Termination Charge. The assumption of these obligations further reduce the Contract Termination Charge by another 20 percent.

VARIABLE COMPONENT REDUCTIONS

Q.Which contractual obligations included in the Contract Termination Charge is USGenNE assuming as part of the Divestiture?

A.As described by Mr. Jesanis, USGenNE is assuming a portion of the payment obligations under NEP's purchased power contracts which were included in the Contract Termination Charge of the original Settlement. In addition, USGenNE is assuming all of the fuel transportation contracts.

Q.What portion of the power contracts must NEP pay to induce USGenNE to assume the purchased power contracts?

A.NEP will pay an average of $160 million per year for approximately 10 years to "buy out" of the purchased power contracts. These payments come in the form of reductions in the payments that USGenNE must make under the contracts. USGenNE reimburses NEP less than the amount of the payments due under the contracts. The monthly contributions by NEP are fixed under the agreement with USGenNE. The sum of the USGenNE reimbursement and the NEP contribution will total the entire obligation which NEP will pay to the power suppliers. Assuming a July 1, 1998 closing, NEP's annual contributions are as follows: (I) $170 million annually, or $14.2 million monthly for 57 months, (ii) $160 million annually, or $13.3 million monthly for 1 month, and (iii) $150 million annually, or $12.5 million monthly for 57 months. These anticipated payments are significantly lower than the above-market purchased power cost estimates included in original Settlement, therefore it is beneficial to substitute the previous estimate as soon as possible upon Divestiture. This substitution is made in the formula and schedules included in Exhibits JLK-2, JLK-3 and JLK-6. In addition, the IPP Transfer Agreement provides that NEP will, with the consent of USGenNE, make lump sum payments to the power supplier or as otherwise directed by USGenNE upon final Settlement and release of NEP's obligations under the contracts. In addition, the contract requires NEP to pay transmission costs necessary to deliver the power from these contracts to the PTF System. However, under NEP's transmission filing made herewith, these costs are eliminated because there are no incremental costs associated with delivery. Should the filing be modified or the interconnection agreement with USGenNE be changed, any additional transmission costs would be added to the Contract Termination Charge.

Q.Is NEP required to pay USGenNE for the assumption of the fuel transportation contracts?

A.No. The purchase price reflects the assumption of the fuel transportation contracts, therefore no collection of above-market fuel transportation costs in the Contract Termination Charge is required after the Divestiture Date. Accordingly, these elements of the Contract Termination Charge have been eliminated from Exhibits JLK-2, JLK-3 and JLK-6.

Q.Are there any other effects of not accumulating Reconciliation Account items through the year 2000?

A.Yes. As discussed above, there are more immediate mitigation benefits realized by reducing the amounts flowing through the Reconciliation Accounts. This approach passes savings through to customers earlier than contemplated in the Settlement. The reductions are offset in the Massachusetts Settlement by the collection of the Termination Charge Mitigation Incentive (Mitigation Incentive). The Mitigation Incentive is collected through the Reconciliation Account and the Reconciliation Account trues-up on an annual basis.

Q.Please quantify the impact of the Variable Component changes on the Contract Termination Charge.

A.The reductions of the Variable Component costs, net of the Mitigation Incentive, lower the Contract Termination Charge by 20% over the period, as calculated on a net present value basis.

TOTAL SAVINGS

Q.Please quantify the total impact of Divestiture related savings on the Contract Termination Charge.

A.Total Divestiture related savings over the entire period that the Contract Termination Charge is collected are expected to be 50% as compared to the original Settlement. If retail access is broadly available at the Divestiture Date and no holdback occurs, the Contract Termination Charge will equal 1.5 cents per kilowatthour initially. This charge compares to the 2.8 cents per kilowatthour initial Contract Termination Charge included in the original Settlement, and includes both Residual Value Credit and Variable Component changes as described above. The post-Divestiture Contract Termination Charge will decline from 1.5 cents per kilowatthour to approximately 1.1 cents per kilowatthour in 2001, then to .3 cents per kilowatthour in 2008, and finally to approximately .1 cents per kilowatthour in 2011 through 2029. Please refer to Exhibits JLK-2 and JLK-6. Note that if the holdback occurs because retail access is delayed, the Contract Termination Charge upon Divestiture through 2000 will equal approximately 1.9

cents per kilowatthour rather than 1.5 cents per kilowatthour. Please refer to Exhibit JLK-3.

OTHER ADJUSTMENTS TO THE CONTRACT TERMINATION CHARGE

Q.Are there any other proposed adjustments to the Contract Termination Charge that are unrelated to Divestiture?

A.Yes. On August 1, 1997 the Board of Directors of the Maine Yankee nuclear unit voted to close the unit permanently. As a result, capital recovery for Maine Yankee has been removed from the Fixed Component because it will be included as part of the shutdown and decommissioning costs that NEP will be billed by Maine Yankee. These shutdown and decommissioning costs are fully collected through the Variable Component, and a revised estimate of these costs has been included in the Contract Termination Charge. Please refer to Exhibits JLK-2, JLK-3, and JLK-6, Schedule 1, page 8.

SUMMARY

Q.Ms. Kenney, please briefly summarize your testimony.

A.The results of NEP's Divestiture dramatically reduce Mass. Electric's Contract Termination Charge obligation. Compared to the Settlement filed with this Commission in May, the overall Contract Termination Charge obligation is cut by 50%. This significant amount of savings is passed through the Contract Termination Charge via the Residual Value Credit which is amortizes Net Proceeds through 2000 as opposed to through 2009, and the immediate changes in the estimates of the Variable Component cost items upon Divestiture. In the base case, assuming no holdback, the Contract Termination Charge drops from 2.80 cents per kilowatthour to 1.50 cents per kilowatthour initially, and continues to decline over time, producing dramatic rate reductions to ultimate customers, as illustrated by Mr. Zschokke in his testimony.

Q.Does this conclude your testimony?

A.Yes it does.

NEW ENGLAND POWER COMPANY

AMENDMENT TO SERVICE AGREEMENT WITH

MASSACHUSETTS ELECTRIC COMPANY UNDER

FERC ELECTRIC TARIFF, ORIGINAL VOLUME NO. 1

FORMULA FOR CALCULATING CONTRACT

TERMINATION CHARGES

1.1 The Fixed Component of the Contract Termination Charge shall include Mass. Electric's 72.6 percent allocated share of NEP's costs as shown on Schedule 1, Page 2, which shall include:

1.1.1 Revenues sufficient to amortize over the period commencing on the Divestiture Date defined as the date of closing for the sale of NEP's non-nuclear generating facilities pursuant to the Asset Purchase Agreement dated August 5, 1997, and continuing through December 31, 2000 the actual unrecovered balances for plant and regulatory assets as of the Divestiture Date:

(a) Plant balances shall include the unrecovered net book value as shown on Schedule 1, Page 5, Column (7), of the following NEP generation-related investments as of the Divestiture Date:[1]

[1]The figures shown on Schedule 1, Page 5, Column (7) are estimates assuming that the Retail Access Date, the Contract Termination Date, and the Divestiture Date all occur on July 1, 1998. The estimates will be updated for actual balances as of the Divestiture Date on the "Reconciliation Date" which shall be no later than ninety days after the actual Divestiture Date. Differences shall be reflected in the

(continued...)

(i) Brayton Point Units 1, 2, 3, 4, including the Brayton Point Diesels; Salem Harbor Units 1, 2, 3, 4; Wyman Unit 4;

(ii) Manchester Street Station, including NEP's reimbursement to Narragansett for its ownership share of the Station at Narragansett's net book value, prepaid property tax payments made in accordance with a tax treaty with the City of Providence, and capital additions past December 31, 1995 but committed prior to that date;

(iii) NEP Hydro Units;

(iv) Bear Swamp Pumped Storage Facility;

(v) NEP's Entitlements in the Vermont Yankee Unit;

(vi) NEP's ownership share of Millstone Unit 3;

(vii) NEP's ownership share of Seabrook Unit 1;

(viii) Step-up transformers at NEP generating units which are excluded from NEP's transmission rates;

(ix) General plant allocated to generation;

(x) Generation-related property held for future use and non-utility property;

(xi) Generation-related investment in the Nantucket Diesels; and

(xii) Generation-related investment in the NEP Diesels at Gloucester and Newburyport.

The plant balances for NEP's entitlements and ownership shares in nuclear units (items v, vi, and vii, above) shall also include the balances for the final fuel cores and materials and supplies; and

(b) Regulatory assets shall include the generation-related unrecovered net book balances shown in Schedule 1, Page 6, Column (2), as of the Divestiture Date[2]:

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[1](...continued)
revision under § 1.1.4(a), below. The reconciliations made on the Reconciliation Date shall remain subject to final adjustments or true-ups, if necessary, and any changes shall be reflected in the Reconciliation Account at the time the adjustment or true-up is made.

[2]The figures shown on Schedule 1, page 6, Column 2 are estimates assuming that the Retail Access Date, Contract Termination Date, and Divestiture Date all occur on July 1, 1998. The estimates will be updated for actual balances as of the Divestiture Date on the Reconciliation Date and shall be reflected in the revision under § 1.1.4(a), below. The reconciliations made on the Reconciliation Date shall remain subject to final adjustments or true-ups, if necessary, and any changes shall be reflected in the
(continued...)

(i) FAS 109;
(ii) Unamortized losses on Reacquired Debt;
(iii) Unamortized pipeline demand charges deferred prior to the commercial operation of Manchester Street;
(iv) NEEI;
(v) Unamortized power contract buyout costs;
(vi) Rate clauses;
(vii) Seabrook tax true-up;
(viii) Decontamination and decommissioning costs;
(ix) Unamortized ITC associated with nuclear entitlements; and
(x) W-95 Settlement Adjustment Account to the extent not otherwise recovered.

1.1.2 Revenues sufficient to provide an overall pre-tax return of 11.18 percent[3] based on a combined state and federal income tax rate of 39.225 percent, and NEP's 1995 year-end capital structure as shown in Schedule 1, Page 15, Column (6), including a return on common equity of 9.4 percent,[4] multiplied by the average of the beginning and ending balances in each calendar year beginning in the year of the Contract Termination Date, of the sum of the following:

(a) Unrecovered net book value of NEP's generation investments as defined under 1.1.1(a) above, plus

(b) Unrecovered net book value of generation-related Regulatory Assets as defined under 1.1.1(b) above, excluding the rate clauses and unamortized ITC associated with nuclear entitlements under 1.1.1(b)(vi) and (ix), less

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[2](...continued)
Reconciliation Account at the time the adjustment or true-up is made.

[3]The 11.18 percent shall be used as the return wherever a return is referenced throughout this Appendix. However, the return so calculated shall be adjusted in accordance with Section 1.1.4(e).

[4]For purposes of the Contract Termination Charges, NEP's investments in the Yankee Companies are set at a 9.4 percent equity return.

(c) Deferred Taxes as shown in Schedule 1, Page 14, Column (9), equal to the combined state and federal income tax rate of 39.225 percent, which shall be adjusted for changes in tax laws, multiplied by the sum of:

(i) the unrecovered net book value of NEP's generation investment, plus
(ii) the unrecovered net book value of generation-related regulatory assets, excluding rate clauses, less
(iii) the unrecovered balance of generation investment for tax purposes, less
(iv) the unrecovered balance of generation-related regulatory assets for tax purposes.

1.1.3 Revenues sufficient to: (i) amortize over the period commencing on the Divestiture Date and continuing through December 31, 2009 the generation-related, unrecovered net book balances associated with the FAS 106 Transition Obligation of NEP and allocated to NEP by its affiliates[5]; and (ii) pay a return of 7.25 percent equal to the interest rate reflected in the actuarial analysis of the FAS 106 Transition Obligation of NEP and allocated to NEP by affiliates multiplied by the outstanding balances remaining for the FAS 106 Transition Obligation of NEP and allocated to NEP by affiliates. On the Reconciliation Date, these outstanding balances shall be subject to a one time adjustment as set forth in Section 1.1.4(b) below. At the same time, the interest rate return for the period after the Divestiture Date shall be established using the most current actuarial

[5] Any FAS 106 Transition Obligation of NEP and allocated to NEP by its affiliates that is not allocated to generating facilities shall be deemed transmission related.

analysis available at the time, which rate shall remain in place for the remainder of the fixed cost recovery period.

1.1.4 The Fixed Components shall be subject only to the following adjustments:

(a) On the Reconciliation Date, NEP shall revise the balances in Sections 1.1.1(a) and (b), and the amortization and return for the period between the Divestiture Date and December 31, 2000 to reflect the actual balances as of the Divestiture Date. The reconciliations made on the Reconciliation Date shall remain subject to final adjustments or true-ups, if necessary, and any changes shall be reflected in the Reconciliation Account at the time the adjustment or true-up is made.

(b) , On the Reconciliation Date, NEP shall reconcile the balances as of the Divestiture Date in Sections 1.1.1 and 1.1.3 for Mass. Electric's 72.6 percent allocated share of (i) the unrecognized transition obligation, prior service cost, and unrecognized gains or losses associated with the FAS 106 obligation; and (ii) the unrecognized transition obligation, prior service cost, and unrecognized gains or losses associated with the FAS 87 obligation, but the gains or losses associated with FAS 87 shall be recognized only to the extent that they exceed five percent of the greater of plan assets or liabilities. NEP shall fund the FAS 106 and FAS 87 obligations under this Section and Section 1.2.3(f) as rapidly as permitted by the tax law up to the level of revenues collected for this purpose.[6] Any revenues associated with these obligations that cannot be immediately funded shall be put into a separate account on the books to be reserved with the return specified in Section 1.1.3 until tax deductible funding becomes possible. The one-time adjustment associated with FAS 106 and FAS 87, whether positive or negative, shall be subtracted from or added to the schedules for prospective recovery of FAS 106, as appropriate, and amortized with the return specified in Section 1.1.3 over the period between the date of the reconciliation and December 31, 2009. An exhibit showing the reconciliations is included in Schedule 3, page 1. In addition, NEP shall reconcile the balances as of the Divestiture Date for Mass. Electric's 72.6 percent allocated share of (iii) the FAS 109 regulatory asset; and (iv) the general plant allocated to generation, provided, however, that any general plant not allocated to generation shall be functionalized to transmission. The one-time adjustment associated with differences in the balances for FAS 109 and general plant, whether positive or negative, shall be subtracted from or added to the net proceeds reflected in the residual value

[6]The FAS 106 and FAS 87 costs recovered through the Contract Termination Charge shall be reflected as a credit to NEP's transmission rates. NEP's post-divestiture FAS 106 or FAS 87 gains or losses recognized on NEP's books shall be fully reflected in rates to customers and shall neither be retained nor borne by NEP. NEP shall propose an allocation of these post-divestiture gains or losses between customers paying Contract Termination Charges and transmission customers to recognize the higher cash contributions of the customers paying the Contract Termination Charges in the filing implementing the Residual Value Credit.

credit as appropriate and shall be amortized, with the return specified in Section 1.1.2, over the period between the Divestiture Date and December 31, 2009. The adjustments and reconciliations made on the Reconciliation Date pursuant to this subsection shall remain subject to final adjustments and true-ups, if necessary, and any changes shall be reflected in the Reconciliation Account at the time the adjustment or true-up is made.

(c) Upon the sale of NEEI properties, NEP shall reconcile NEEI recovery to reflect the difference between the actual NEEI loss following the sale and the estimated NEEI loss reflected in the Contract Termination Charge. The reconciliation shall credit to Mass. Electric, Mass. Electric's 72.6 percent allocated share of the compounded return that NEP accrued on the NEEI unamortized balance through the Contract Termination Charge prior to the sale of the NEEI properties, and shall account for and reconcile all differences between: (i) actual amortization under NEP's Tariff No. 1 fuel clause as compared to the amortization estimates included in the Contract Termination Charge and Schedule 2 if the Retail Access Date is delayed; (ii) actual balances on NEEI's books at the sale as compared to balances used to calculate the Base Contract Termination Charge; and (iii) actual net proceeds after transaction costs realized from the sale as compared to those used to estimate market value when calculating the Base Contract Termination

Charge. Following the completion of the above reconciliations, Mass. Electric's 72.6 percent allocated share of the differences in the balances, whether positive or negative, shall be subtracted from or added to the Mass. Electric's 72.6 percent allocated share of the balance for NEEI losses and the schedule for prospective recovery of NEEI costs shall be adjusted to amortize, with the return specified in Section 1.1.2, the adjusted balance over the period between the sale and December 31, 2009. An exhibit showing the methodology for the NEEI reconciliation is attached as Schedule 3, page 2. If the Contract Termination Date has not yet occurred at the time the NEEI properties are sold, the same schedule of recovery shall be applied to NEP's Tariff No. 1 fuel clause to Mass. Electric so that NEP fully recovers the revised NEEI recovery from Mass. Electric.

(d) As of the Divestiture Date, [7] NEP shall implement a Residual Value Credit to Mass. Electric. The Residual Value Credit, shown on Schedule 6(a), assumes that the conditions in section 3.4 of the Asset Purchase Agreement have been fully achieved and the additional consideration of $225 million has been paid by the Buyer

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[7] Within three months after the completion of the sale of any other property whose costs have been included in the Contract Termination Charge, NEP shall reflect the net proceeds from the sale as calculated in this section in the Reconciliation Account. NEP shall be authorized to amortize the net proceeds with a return over a period of up to five years if necessary to maintain a stable and declining pattern of Contract Termination Charges. NEP shall be authorized to amortize any Divestiture proceeds previously held-back pursuant to this section in the same manner. Net proceeds, if any, from NEP's future leases of nuclear entitlements will also be flowed through the Reconciliation Account.

at closing. The Residual Value Credit shown on Schedule 6(b) assumes that these conditions have not been met, and the Buyer has held back $225 million at closing. Schedule 6(b) also includes a Revised Schedule 1(b) showing the effect of the $225 million hold-back on the Contract Termination Charge. Both Schedule 6(a) and Schedule 6(b) are based on estimates that will be reconciled on the Reconciliation Date to actual figures as of the Divestiture Date with differences, if any, included in the Reconciliation Account established under 1.2.1. The adjustments and reconciliations made on the Reconciliation Date shall remain subject to final adjustments and true-ups, if necessary, and any changes shall be reflected in the Reconciliation Account at the time the adjustment or true-up is made. The Residual Value Credit is calculated as follows:

(i) Mass. Electric's 72.6 percent allocated share of Total Proceeds[8] equal to the sale price and other consideration received by NEP excluding $85 million[9] which purchasers

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[8]As part of the terms of the Divestiture, NEP has required the buyer of the facility to pay NEP the net book value for all inventories and materials and supplies associated with the generating facility. As a result, inventories and materials and supplies for NEP's non-nuclear facilities are excluded from the plant balances under Section 1.1.1, and are excluded from the calculation of the Residual Value Credit. In addition, the Buyer also purchased from NEP the Company's equity interest in Narragansett Energy Resources Company (NERC). As part of this transaction New England Electric System will contribute the NERC stock to NEP at book value. As a result, the net book value of the stock is subtracted from the proceeds and excluded from the Residual Value Credit.

[9]The $85 million represents total costs of $91 million less $6 million of FAS 106 transition obligation which is being recovered under Section 1.1.3.

have paid into an account for employee benefits pursuant to Section 1.2.3(f), less

(ii) The revenues lost or gained by NEP between the Retail Access Date and the Divestiture Date measured by the difference between the revenues, excluding revenues attributable to items included in the Contract Termination Charge or in NEP's transmission rates, that NEP would have collected under Rate W-95(S) or a superseding wholesale rate, if any, had it continued to make the sales to Mass. Electric under Tariff 1 and the revenues, excluding transmission revenues and Contract Termination Charge revenues, that it actually collected from sales to Mass. Electric's customers during the period, together with a credit for Mass. Electric's share of the revenue from sales at no less than market prices made by NEP to third parties during the period, provided, however, the lost revenues so calculated shall not exceed \$0.008 per kilowatthour multiplied by the number of kilowatthours delivered by Mass. Electric during the period between the Retail Access Date and the Divestiture Date. If the Divestiture Date occurs after January 1, 1999, NEP shall provide a report to the Commission and the Signatories setting forth the reasons for the delay, and demonstrating its reasonableness, less

(iii) Mass. Electric's 72.6 percent allocated share of capital investments demonstrated to be prudently incurred after December 31, 1995, excluded from the plant balances in Section 1.1.1 (a) above,[10] less

(iv) Mass. Electric's 72.6 percent allocated share of reasonable transaction costs associated with the divestiture including the cost of refinancings, repurchases, and retirements of securities occurring after March 20, 1997, in excess of $20 million to NEP.

As shown in Schedule 1, page 2, The Net Proceeds from the divestiture including amortization and the pretax return specified in Section 1.1.2 on the unreturned credit balance net of tax impacts has been credited to the Fixed Component in equal monthly amounts over the period commencing on the Divestiture Date and continuing through December 31, 2000. The Residual Value Credit shall be implemented even if: (i) the Divestiture Date occurs before the Retail Access Date, in which event Mass. Electric shall

[10]NEP's capital investments shall include construction work in progress. The investments in non-nuclear generating facilities in 1996 are shown in Schedule 4. These projects have been reviewed by the parties and are included as an offset to the Residual Value Credit subject only to a further review for the reasonableness of the amounts expended in the construction of the projects under Section 3.5 of the Agreement. NEP may include additional projects, if any, as of the Divestiture Date in the reconciliation to be made on the Reconciliation Date subject to the dispute resolution procedures under Section 3.5 of the Agreement.

implement the Wholesale Access Date in accordance with Section 6.1.1, n. 3 of the Agreement, or (ii) the Residual Value Credit exceeds the Contract Termination Charge in any given year.

(e) Effective with refinancings, repurchases, and retirements of securities on and after March 20, 1997, NEP shall on the Reconciliation Date, for all purposes associated with the implementation of the Contract Termination Charge or the Residual Value Credit, flow through the Reconciliation Account the annual effects associated with any differences between NEP's 11.18 percent overall pre-tax return and the actual pre-tax return, calculated using a 9.4 percent return on common equity, attributable to changes in the cost of debt, preferred stock, capital structure or income tax rates, provided that the overall pre-tax return shall not exceed 11.18 percent so long as the yield on 10-year Treasury constant maturities as reported in the Federal Reserve Statistical Release is 9 percent or lower. In the event that the yield on Treasury maturities as so reported exceeds 9 percent, the 11.18 percent overall pre-tax return shall be adjusted to include NEP's actual cost of debt and preferred stock using a 9.4 percent return on common equity. This reconciliation will apply to the period following the Divestiture Date whether or not securitization has been implemented. Notwithstanding the foregoing, nothing shall require a change in capital structure prior to any financing to take advantage of securitization.

NEP shall not be required to implement securitization unless implementation would produce net savings after taking into account all transaction costs including call provisions and prepayments, if applicable.

Any and all financing savings associated with refinancing following divestiture or securitization shall be allocated to the Contract Termination Charge through this paragraph, and shall not be reflected in NEP's capital structure used for transmission rates. To the extent any financing savings are allocated to transmission rates by the Commission, however, they shall not also be allocated to the Contract Termination Charge under this paragraph.

1.2 The Variable Component of the Contract Termination Charge shall include Mass. Electric's allocated share of the items specified in Section 1.2.3, below adjusted for the Reconciliation Account discussed in Sections 1.2.1 and 1.2.2, below.

1.2.1 The Variable Component shall be adjusted through a Reconciliation Adjustment in which differences, whether positive or negative, between the estimates for Contract Termination Charge Payments by Mass. Electric and Mass. Electric's allocated share of the estimated variable costs listed in Section 1.2.3 below and actual Contract Termination Charge payments by Mass. Electric and its allocated share of the actual variable costs will be accumulated in a Reconciliation Account and added to or subtracted from the Contract Termination Charge from

NEP to Mass. Electric. The Reconciliation Account shall also include the adjustments if any under Section 1.1.4 above, caused by (i) a change in the Divestiture Date, (ii) any other revisions to the Fixed Component associated with the reconciliations, adjustments, or true-ups that are completed on or after the Reconciliation Date, (iii) future sales of property or leases of nuclear entitlements, and (iv) changes in cost of capital. A pretax return equal to that specified in Section 1.1.2 shall be included on any balance in the Reconciliation Account, whether positive or negative.

The Reconciliation Account shall accumulate each year and shall be used to adjust NEP's Base Contract Termination Charges to Mass. Electric in the following year. Thus, NEP shall return or collect Mass. Electric's allocated share of any outstanding balance in the Reconciliation Account by implementing an adjustment to the Contract Termination Charges to Mass. Electric in the following year. Reconciliation Account adjustments to the Contract Termination Charges shall not cause the Contract Termination Charges to exceed 2.8 cents per kilowatthour. Any deferrals caused by the limitation in the prior sentence shall be carried forward with a return into the next annual adjustment to the Contract Termination Charge.

1.2.2 Through December 31, 2009, the Reconciliation Account includes a Termination Charge Mitigation Incentive which increases the Variable Cost Component because NEP has mitigated the Contract Termination Charge and reduced the estimated cumulative average of the cents per kilowatthour Contract Termination Charge to Mass. Electric below 2.8 cents per kilowatthour. The schedule of rewards for each level of the cumulative average Contract Termination Charge in each year from 1998 through 2009 is shown on Schedule 1, page 4.

1.2.3 Mass. Electric's 72.6 percent allocated share of the specific cost items included in the Variable Component are set forth in Schedule 1 at page 3. The difference between Mass. Electric's 72.6 percent allocated share of the actual variable costs incurred by NEP and the estimated variable costs in this section shall be included in the Reconciliation Account. The costs included in the Variable Component shall include the following:

(a) <u>Nuclear Decommissioning and Other Post Shutdown Costs</u> shown in Schedule 1, Pages 7 and 8, shall include: (i) all charges, excluding any net incremental decommissioning costs caused by operations after the Retail Access Date, for decommissioning and site restoration assessed to NEP by the operators of each nuclear electric generating facility specified in Section 1.1.1(a) (v), (vi) and (vii) above, subject to the regulatory authority of the agencies having jurisdiction over the operation and collection of such funds, (ii) all other reasonable post shutdown costs associated with NEP's entitlements in the units listed in Section 1.1.1(a)(v), (vi) and (vii) above; and (iii) all remaining reasonable costs, including decommissioning costs and unrecovered capital costs, associated with Yankee Rowe, Connecticut Yankee, and Maine Yankee shown on Schedule 1, page 8. Funding for the decommissioning costs will be placed in irrevocable trusts in accordance with NRC regulations. If, upon the completion of decommissioning for any of the above listed nuclear generating facilities, it is determined that there has been an over collection of funds, such over collection will be transferred to NEP's decommissioning fund for either Millstone 3 or Seabrook 1 pending final disposition of their decommissioning. Once all decommissioning is complete, any over collection will be refunded to Mass. Electric in the Reconciliation Adjustment. Other post shutdown costs will also be fully reconciled in the Reconciliation Adjustment.

(b) Power Contract Payments will be (i) all payments by NEP for Long-Term Power Supply Contracts less the payments received from the Buyer or from resale of electricity purchased under the contracts into the wholesale market which are as shown on Schedule 1, plus (ii) Economic Buyout Payments associated with those contracts, less (iii) Credit for Unit Sales Contracts.

(i) Long-Term Power Supply Contracts will be all power supply contracts in place as of December 31, 1995, between NEP and a third party supplier, continuing to the termination date of each contract. The Long-Term Supply Contracts include:

(1) Ocean State Power

(2) Canal
(3) NU Slice
(4) Lawrence Hydro
(5) Mascoma Hydro
(6) Pontook Hydro
(7) Northeast Landfill
(8) Turnkey

(9) Ogden Haverhill
(10) RESCO Saugus
(11) RESCO N. Andover
(12) Signal - Millbury
(13) Hydro MWRA
(14) RFA Lawrence
(15) ALTRESCO
(16) Clark University
(17) Milford Power
(18) Pawtucket
(19) Barre Landfill
(20) Nashua Landfill
(21) Hydro Quebec

(ii) Economic Buyout Payments will be the trigger payments agreed to by NEP under Section 8(d) of the PPA Transfer Agreement, associated with the disposition of the Long-Term Power Supply Contracts. Economic Buyout Payments shall be recovered as incurred to the extent that current recovery does not increase rates to customers above the level that would have been incurred absent the disposition of the Long-Term Power Supply Contract. The portion of the Economic Buyout Payment that cannot be recovered currently under the prior sentence shall be deferred and recovered with the return specified in Section 1.1.2 as soon as such recovery will not increase rates to customers above the level that would have been incurred absent the sale, assignment, disposition, or buy down of the Long-Term Power Supply Contract.

(iii) Credit for Unit Sales Contracts will be all unit sales contracts entered into by NEP as of December 31, 1995, for sales from the following generating units if they are not otherwise subject to market valuation less the market value of these contracts as shown in Schedule 1, Page 3, Columns (7) through (9). Units Sales Contracts include contracts for NEP's sale of power from the following units:

(1) Maine Yankee
(2) Millstone 3
(3) Seabrook I

(d) (i) Transmission wheeling charges for the units sold to the Buyer or for the contracts set forth in Section 1.2.3(b) to the extent the transmission wheeling charges exceed the charges that would be payable under NEP's proposed pricing policy that is incorporated in the Tariff No. 9 filing and Continuing Site/ Interconnection Agreement filed by NEP on October 1, 1997, and (ii) transmission wheeling charges as shown in Schedule 1, Page 3, associated with the transmission of electricity from NEP's entitlements in Connecticut Yankee, Millstone Unit 3, Wyman Unit 4, and Vermont Yankee, which units are located off of NEP's transmission system, together with support payments to Central Maine Power and Connecticut Light and Power which are necessary for the transmission of NEP's remote generation. These wheeling and support payments shall include only costs that are excluded from recovery under NEP's and

NEPOOL's open access transmission tariffs or are not assigned to a purchaser of the unit.

(e) Payments in Lieu of Property Taxes will include all reasonable costs incurred by NEP or its affiliates associated with payments in lieu of property taxes to the cities and towns in which NEP owns generating facilities to mitigate the loss of tax revenues that those cities and towns would otherwise incur in connection with restructuring. For the purposes of calculating the Base Contract Termination Charges and the estimate included in the Reconciling Account, the Payments in Lieu of Property Taxes are assumed to be zero.

(f) Employee Severance and Retraining as shown in Schedule 1, page 3, Column (13), will include all reasonable costs and expenses incurred by NEP or its affiliates associated with the adjustment of their workforces in connection with the implementation of retail access, divestiture, or the termination of NEP's Tariff No 1, including, but not limited to early retirement, severance, retraining and other reasonable costs associated with the implementation of the benefits to employees included in Schedule 5. NEP shall require purchasers of its generating business to pay $85 million for the costs under this paragraph incurred by NEP and its affiliates. In the event that the actual costs incurred by NEP and its affiliates under this paragraph are less than $85 million, excluding costs found by the Commission to be recoverable in NEP's transmission rates, NEP shall flow back the difference to customers in the Reconciliation Account. The procedure established in this paragraph shall be the exclusive method for recovering the costs under this paragraph, and, except in the event of legislation changing required benefits, neither NEP nor its affiliates shall be able to recover more than $85 million for these costs. Thus, for the purposes of calculating the Base Contract Termination Charges and the estimate included in the Reconciliation Account, the Employee Severance and Retraining Costs are assumed to be zero and, except in the event of legislation changing required benefits, these costs shall not result in an increase to the Reconciliation Account or to the Contract Termination Charge.

(g) Damages, Costs, or Net Recoveries from claims by or against third parties shall include all damages, costs, or recoveries associated with NEP's generating business which accrued prior to the date of divestiture and which were not: (i) included in the reserves for generation related, uninsured claims other than claims associated with Environmental Response Costs as of January 1, 1995, plus annual additions to the reserves for uninsured claims in NEP's W-95(S) rate, less actual payments out of the reserve for generation related claims during the period from January 1, 1995 through the Contract Termination Date; (ii) assigned to NEP's successor in interest; (iii) recovered from NEP's insurance carriers; (iv) the result of gross negligence. For the purposes of calculating the Base Contract Termination Charges and the estimate included in the

Reconciliation Account, Damages, Costs, or Net Recoveries from claims were assumed to be zero.

(h) Performance Based Rate for Nuclear Units Remaining After Divestiture shall credit value received that is not otherwise reflected in the Residual Value Credit, or recover any payments or costs associated with the sale, lease or disposal of nuclear units or entitlements that are not otherwise reflected in the Residual Value Credit. If NEP is unable to sell, lease, assign, or otherwise dispose of its nuclear units or entitlements on the terms set forth in the Agreement prior to the Contract Termination Date, the Performance Based Rate shall include 80 percent of the reasonable going forward costs, including variable costs and capital additions, on a cost of service basis[11] associated with NEP's nuclear units or entitlements that are not otherwise recovered in contract termination charges less 80 percent of the revenues from sales of energy or capacity from such units or entitlements that are not otherwise reflected in contract termination charges. The Performance Based Rate shall apply for the period from the Contract Termination Date to the date that NEP either sells, leases, assigns or otherwise disposes of the nuclear unit or entitlement of the nuclear unit is shutdown. Within six months prior to implementing the Performance Based Rate, NEP will consult with the Signatories on a performance standard for nuclear safety indicators and will file such

[11] In the event that the nuclear unit is retired before the end of its license life, the capital addition shall be amortized with a return over the remainder of the license or in accordance with its depreciation schedule, whichever is shorter.

performance standard with a maximum potential credit for non-performance of $1 million. Such sales, if any, shall only be made in the wholesale market to non-affiliates provided, however, that NEP shall retain the right to use its minority shares of the units or entitlements to fulfill its minimum, zero bid obligations under the standard offer. For the purpose of calculating the Base Contract Termination Charges and the estimate included in the Reconciliation Account, the Performance Based Rate for Nuclear Units is assumed to be zero.

(i) Environmental Response Costs defined as:

(i) Reasonable and prudently incurred costs associated with the investigation, testing, remediation, liabilities, damages, claims, settlements, or judgments attributable to or incurred by NEP or Narragansett relating to deposits or waste from divested generating facilities off the site of properties sold, whether or not such material is regulated under the statutes and authorities referenced in paragraph (iv), including material deposited before the Divestiture Date at disposal sites, sites to which material may have migrated from off-site disposal sites, or any off-site location at which generation related material may have been deposited before the Divestiture Date associated with the operation of generating facilities sold pursuant to the divestiture plan;

(ii) Reasonable and prudently incurred costs associated with the investigation, testing, remediation, liabilities, damages, claims, settlements, or judgments attributable to or incurred by NEP or Narragansett relating to deposits and wastes occurring prior to the Divestiture Date whether or not such material is regulated under the statutes and authorities referenced in paragraph (iv) from facilities located either within the switchyards for which NEP will retain a permanent easement on parcels that are otherwise being divested or the Brayton Point step-up transformers if such costs are not recovered in transmission rates;

(iii) Reasonable and prudently incurred costs associated with the purchase of property that is acquired as part of an overall mitigation and response plan associated with sites identified in paragraphs (i) and (ii);

(iv) The statutes and authorities referenced in paragraphs (i) and (ii) shall be the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), Resource Conservation and Recovery Act (RCRA), Massachusetts G.L. c. 21C and 21E, and Rhode Island General Laws 23-19.14, or any other laws, regulations or orders by courts or governmental authorities, or resulting from claims and contentions arising in tort, breach of contract or violation of law;

(v) Except for property acquired under paragraph (iii), Environmental Response Costs shall not include costs associated with the investigation, testing, remediation, or other liabilities relating to property acquired after the Divestiture Date. Environmental Response Costs recovered under paragraphs (i), (ii), and (iii) shall also be offset by: (i) reserves related to Environmental Response Costs as of January 1, 1995, less actual payments out of the Reserve for Environmental Response Costs during the period from January 1, 1995 through the Contract Termination Date; (ii) proceeds from insurance companies related to Environmental Response Costs; (iii) proceeds from the sale of properties purchased under paragraph (iii); and (iv) recoveries from third parties;

(vi) Nothing herein is intended to limit, alter, or otherwise affect any liability of NEP to governmental authorities or third parties other than the buyer or buyers of NEP generating facilities under any environmental law including those referenced in paragraph (iv).

NEW ENGLAND POWER COMPANY

AMENDMENT TO SERVICE AGREEMENT WITH

MASSACHUSETTS ELECTRIC COMPANY UNDER

FERC ELECTRIC TARIFF, ORIGINAL VOLUME NO. 1

FORMULA FOR CALCULATING CONTRACT

TERMINATION CHARGES

1.1 The Fixed Component of the Contract Termination Charge shall include Mass. Electric's 72.6 percent allocated share of NEP's costs as shown on Schedule 1, Page 2, which shall include:

1.1.1 Revenues sufficient to amortize over ~~a twelve year~~ the period commencing on ~~January 1, 1998~~ the Divestiture Date defined as the date of closing for the sale of NEP's non-nuclear generating facilities pursuant to the Asset Purchase Agreement dated August 5, 1997, and continuing through December 31, ~~2009~~ 2000 the ~~following~~ actual unrecovered balances for plant ~~balances~~ and regulatory assets as of the Divestiture Date:

(a) Plant balances shall include the unrecovered net book value as shown on Schedule 1, Page 5, Column (7), of the following NEP generation-related investments as of ~~January 1, 1998,~~the Divestiture Date:[12] ~~excluding any capital additions made after December 31, 1995:~~

(i) Brayton Point Units 1, 2, 3, 4, including the Brayton Point Diesels; Salem Harbor Units 1, 2, 3, 4; Wyman Unit 4;
(ii) Manchester Street Station, including NEP's reimbursement to Narragansett for its ownership share of the Station at Narragansett's net book value, prepaid property tax payments made in accordance with a tax treaty with the City of Providence, and capital additions past December 31, 1995 but committed prior to that date;
(iii) NEP Hydro Units;
(iv) Bear Swamp Pumped Storage Facility;
(v) NEP's Entitlements in the ~~Maine Yankee and~~ Vermont Yankee Unit~~s~~;
(vi) NEP's ownership share of Millstone Unit 3;
(vii) NEP's ownership share of Seabrook Unit 1;
(viii) Step-up transformers at NEP generating units which are excluded from NEP's transmission rates;
(ix) General plant allocated to generation;
(x) Generation-related property held for future use and non-utility property;
(xi) Generation-related investment in the Nantucket Diesels; and
(xii) Generation-related investment in the NEP Diesels at Gloucester and Newburyport.

The plant balances for NEP's entitlements and ownership shares in nuclear units (items v, vi, and vii, above) shall also include the balances for the final fuel cores and materials and supplies; and

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[12] The figures shown on Schedule 1, Page 5, Column (7) are estimates assuming that the Retail Access Date, the Contract Termination Date, and the Divestiture Date all occur on July 1, 1998. The estimates ~~and~~ will be updated for actual balances as of the Divestiture Date on the "Reconciliation Date" which shall be no later than ninety days after the actual Divestiture Date. Differences shall be reflected in the revision under § 1.1.4(a), below. The reconciliations made on the Reconciliation Date shall remain subject to final adjustments or true-ups, if necessary, and any changes shall be reflected in the Reconciliation Account at the time the adjustment or true-up is made. ~~as of December 31, 1997. Changes, if any, shall be reconciled at the Divestiture Date.~~

(b) Regulatory assets shall include the generation-related unrecovered net book balances shown in Schedule 1, Page 6, Column (2), as of ~~December 31, 1997~~the Divestiture Date[13]:

(i) FAS 109;
(ii) Unamortized losses on Reacquired Debt;
(iii) Unamortized pipeline demand charges deferred prior to the commercial operation of Manchester Street;
(iv) NEEI;
(v) Unamortized power contract buyout costs;
(vi) Rate clauses;
(vii) Seabrook tax true-up;
(viii) Decontamination and decommissioning costs;
(ix) Unamortized ITC associated with nuclear entitlements; and
(x) W-95 Settlement Adjustment Account to the extent not otherwise recovered.

1.1.2 Revenues sufficient to provide an overall pre-tax return of 11.18 percent[14] based on a combined state and federal income tax rate of 39.225 percent, and NEP's 1995 year-end capital structure as shown in Schedule 1, Page 15, Column (6), including a return on common equity of 9.4 percent,[15] multiplied by the

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[13]The figures shown on Schedule 1, page 6, Column 2 are estimates assuming that the Retail Access Date, Contract Termination Date, and Divestiture Date all occur on July 1, 1998. The estimates ~~and~~ will be updated for actual balances as of the Divestiture Date on the Reconciliation Date and shall be reflected in the revision under § 1.1.4(a), below. The reconciliations made on the Reconciliation Date shall remain subject to final adjustments or true-ups, if necessary, and any changes shall be reflected in the Reconciliation Account at the time the adjustment or true-up is made. ~~as of December 31, 1997. In addition, the balance in the W-95 Settlement Adjustment Account will be updated again at the Contract Termination Date if the W-95(S) rate has not been superseded at that time. Changes, if any, shall be reconciled at the Divestiture Date.~~

[14]The 11.18 percent shall be used as the return wherever a return is referenced throughout this Appendix. However, the return so calculated shall be adjusted in accordance with Section 1.1.4(e).

[15]~~The common equity return of 9.4 percent will also be applied to NEP's equity investment in the Ocean State Power facility for purposes of calculating Contract Termination Charges under the Amendment. In addition f~~For purposes of the Contract Termination Charges, NEP's investments in the Yankee Companies are set at a 9.4 percent equity return.

average of the beginning and ending balances in each calendar year beginning in the year of the Contract Termination Date, of the sum of the following:

(a) Unrecovered net book value of NEP's generation investments as defined under 1.1.1(a) above, plus

(b) Unrecovered net book value of generation-related Regulatory Assets as defined under 1.1.1(b) above, excluding the rate clauses and unamortized ITC associated with nuclear entitlements under 1.1.1(b)(vi) and (ix), less

(c) Deferred Taxes as shown in Schedule 1, Page 14, Column (9), equal to the combined state and federal income tax rate of 39.225 percent, which shall be adjusted for changes in tax laws, multiplied by the sum of:

(i) the unrecovered net book value of NEP's generation investment, plus

(ii) the unrecovered net book value of generation-related regulatory assets, excluding rate clauses, less

(iii) the unrecovered balance of generation investment for tax purposes, less

(iv) the unrecovered balance of generation-related regulatory assets for tax purposes.

1.1.3 Revenues sufficient to: (i) amortize over ~~a twelve year~~ the period commencing on ~~January 1, 1998~~ the Divestiture Date and continuing through December 31, 2009 the generation-related, unrecovered net book balances associated with the FAS 106 Transition Obligation of NEP and allocated to NEP by its affiliates[16]; and (ii) pay a return of 7.25 percent equal to the interest rate reflected in the actuarial analysis of the FAS 106

[16] Any FAS 106 Transition Obligation of NEP and allocated to NEP by its affiliates that is not allocated to generating facilities shall be deemed transmission related.

Transition Obligation of NEP and allocated to NEP by affiliates multiplied by the outstanding balances remaining for the FAS 106 Transition Obligation of NEP and allocated to NEP by affiliates. ~~Following the date on which NEP divests its non-nuclear generating facilities ("Divestiture Date"),~~~~[17]~~ On the Reconciliation Date, these outstanding balances shall be subject to a one time adjustment as set forth in Section 1.1.4(b) below. At the same time, the interest rate return for the period after the Divestiture Date shall be established using the most current actuarial analysis available at the time, which rate shall remain in place for the remainder of the fixed cost recovery period.

1.1.4 The Fixed Components shall be subject only to the following adjustments:

(a) ~~For each month that the Contract Termination Date is delayed beyond January 1, 1998,~~ On the Reconciliation Date, NEP shall ~~adjust~~ revise the balances in Sections 1.1.1(a) and (b), and the amortization and return for the period between the Divestiture Date and December 31, 2000 to reflect the actual balances as of the Divestiture Date. The reconciliations made on the Reconciliation Date shall remain subject to final adjustments or true-ups, if necessary, and any changes shall be reflected in the Reconciliation Account at the time the adjustment or true-up is made.

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[17]~~If NEP sells its non-nuclear generating facilities in more than one transaction, the rights and obligations associated with the divestiture shall be allocated among the transactions using appropriate allocators. The FAS 106 transition obligation and adjustments shall be allocated based on the ratio of direct payroll costs at each generating facility sold to total direct payroll costs at all of NEP's non-fossil generating facilities.~~

~~Reconciliation Account in the Variable Component of the Contract Termination Charge by an amount equal to the difference between the depreciation and amortization expense authorized under the W-95(S) rate or a superseding wholesale rate, if any, and the depreciation and amortization under Section 1.1.1, multiplied by Mass. Electric's 72.6 percent allocated share. An exhibit showing the difference between depreciation and amortization under the W-95(S) rate and the Contract Termination Charge is included in Schedule 2.~~

(b) ~~Following the Within 90 days from the Divestiture Date and at the time of implementing the Residual Value Credit~~, On the Reconciliation Date, NEP shall reconcile the balances as of the Divestiture Date in Sections 1.1.1 and 1.1.3 for Mass. Electric's 72.6 percent allocated share of (i) the unrecognized transition obligation, prior service cost, and unrecognized gains or losses associated with the FAS 106 obligation; and (ii) the unrecognized transition obligation, prior service cost, and unrecognized gains or losses associated with the FAS 87 obligation, but the gains or losses associated with FAS 87 shall be recognized only to the extent that they exceed five percent of the greater of plan assets or liabilities. NEP shall fund the FAS 106 and FAS 87 obligations under this Section and Section 1.2.3(f) as rapidly as permitted by the tax law up to the level of revenues collected for this purpose.[18] Any revenues associated with these obligations that cannot be immediately funded shall be put into a separate account on the books to be reserved with the return specified in Section 1.1.3 until tax deductible funding becomes possible. The one-time adjustment associated with FAS 106 and FAS 87, whether positive or negative, shall be subtracted from or added to the schedules for prospective recovery of FAS 106, as appropriate, and amortized with the return specified in Section 1.1.3 over the period between the ~~sale~~ date of the reconciliation and December 31, 2009. An exhibit showing the reconciliations is included in Schedule 3, page 1. In addition, NEP shall reconcile the balances as of the Divestiture Date for Mass. Electric's 72.6 percent allocated share of (iii) the FAS 109 regulatory asset; and (iv) the general plant allocated to generation, provided, however, that any general plant not allocated to generation shall be functionalized to transmission. The one-time adjustment associated with differences in the balances for FAS 109 and general plant, whether positive or negative, shall be subtracted from or added to the net proceeds reflected in the residual value

[18]The FAS 106 and FAS 87 costs recovered through the Contract Termination Charge shall be reflected as a credit to NEP's transmission rates. NEP's post-divestiture FAS 106 or FAS 87 gains or losses recognized on NEP's books shall be fully reflected in rates to customers and shall neither be retained nor borne by NEP. NEP shall propose an allocation of these post-divestiture gains or losses between customers paying Contract Termination Charges and transmission customers to recognize the higher cash contributions of the customers paying the Contract Termination Charges in the filing implementing the Residual Value Credit.

credit as appropriate and shall be amortized, with the return specified in Section 1.1.2, over the period between the ~~sale~~ Divestiture Date and December 31, 2009. The adjustments and reconciliations made on the Reconciliation Date pursuant to this subsection shall remain subject to final adjustments and true-ups, if necessary, and any changes shall be reflected in the Reconciliation Account at the time the adjustment or true-up is made.

(c) Upon the sale of NEEI properties, NEP shall reconcile NEEI recovery to reflect the difference between the actual NEEI loss following the sale and the estimated NEEI loss reflected in the Contract Termination Charge. The reconciliation shall credit to Mass. Electric, Mass. Electric's 72.6 percent allocated share of the compounded return that NEP accrued on the NEEI unamortized balance through the Contract Termination Charge prior to the sale of the NEEI properties, and shall account for and reconcile all differences between: (i) actual amortization under NEP's Tariff No. 1 fuel clause as compared to the amortization estimates included in the Contract Termination Charge and Schedule 2 if the Retail Access Date is delayed; (ii) actual balances on NEEI's books at the sale as compared to balances used to calculate the Base Contract Termination Charge; and (iii) actual net proceeds after transaction costs realized from the sale as compared to those used to estimate market value when calculating the Base Contract Termination

Charge. Following the completion of the above reconciliations, Mass. Electric's 72.6 percent allocated share of the differences in the balances, whether positive or negative, shall be subtracted from or added to the Mass. Electric's 72.6 percent allocated share of the balance for NEEI losses and the schedule for prospective recovery of NEEI costs shall be adjusted to amortize, with the return specified in Section 1.1.2, the adjusted balance over the period between the sale and December 31, 2009. An exhibit showing the methodology for the NEEI reconciliation is attached as Schedule 3, page 2. If the Contract Termination Date has not yet occurred at the time the NEEI properties are sold, the same schedule of recovery shall be applied to NEP's Tariff No. 1 fuel clause to Mass. Electric so that NEP fully recovers the revised NEEI recovery from Mass. Electric.

(d) ~~NEP has agreed to divest its generating business~~ As of the Divestiture Date, [19] NEP shall implement a ~~within six months after the later of the Retail Access Date or the receipt of all governmental approvals and other consents necessary for the divestiture. Within three months after the completion of divestiture~~

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[19] Within three months after the completion of the sale of any other property whose costs have been included in the Contract Termination Charge, NEP shall reflect the net proceeds from the sale as calculated in this section in the Reconciliation Account. NEP shall be authorized to amortize the net proceeds with a return over a period of up to five years if necessary to maintain a stable and declining pattern of Contract Termination Charges. NEP shall be authorized to amortize any Divestiture proceeds previously held-back pursuant to this section in the same manner. Net proceeds, if any, from NEP's future leases of nuclear entitlements will also be flowed through the ~~Residual Value Credit~~ Reconciliation Account.

~~or the sale of any property,[20] the cost of which is included in the Contract Termination Charge, NEP shall implement a Residual Value Credit as a direct offset to the Contract Termination Charges authorized under this Amendment. The~~ Residual Value Credit to Mass. Electric. ~~shall be~~ The Residual Value Credit, shown on Schedule 6(a), assumes that the conditions in section 3.4 of the Asset Purchase Agreement have been fully achieved and the additional consideration of $225 million has been paid by the Buyer at closing. The Residual Value Credit shown on Schedule 6(b) assumes that these conditions have not been met, and the Buyer has held back $225 million at closing. Schedule 6(b) also includes a Revised Schedule 1(b) showing the effect of the $225 million hold-back on the Contract Termination Charge. Both Schedule 6(a) and Schedule 6(b) are based on estimates ~~calculated as follows~~ that will be reconciled on the Reconciliation Date to actual figures as of the Divestiture Date with differences, if any, included in the Reconciliation Account established under 1.2.1. The adjustments and reconciliations made on the Reconciliation Date shall remain subject to final adjustments and true-ups, if necessary, and any changes shall be reflected in the Reconciliation Account at the time

[20] ~~Proceeds, if any, from NEP's future leases of nuclear entitlements will also be flowed through the Residual Value Credit.~~

the adjustment or true-up is made. The Residual Value Credit is calculated as follows:

(i) Mass. Electric's 72.6 percent allocated share of Total Proceeds[21] equal to the sale price and other consideration received by NEP excluding $85 million[22] which purchasers ~~will be required to pay~~ have paid into an account for employee benefits pursuant to Section 1.2.3(f), less

(ii) The revenues lost or gained by NEP between the Retail Access Date and the Divestiture Date~~[23]~~ measured by the difference between the revenues, excluding revenues attributable to items included in the Contract Termination Charge or in NEP's transmission rates, that NEP would have collected under Rate W-95(S) or a superseding

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[21]As part of the terms of the Divestiture, NEP has ~~shall~~ required the buyer of the facility to pay NEP the net book value for all inventories and materials and supplies associated with the generating facility. As a result, inventories and materials and supplies for NEP's non-nuclear facilities are excluded from the plant balances under Section 1.1.1, and ~~shall be~~ are excluded from the calculation of the Residual Value Credit. In addition, the Buyer also purchased from NEP the Company's equity interest in Narragansett Energy Resources Company (NERC). As part of this transaction New England Electric System will contribute the NERC stock to NEP at book value. As a result, the net book value of the stock is subtracted from the proceeds and excluded from the Residual Value Credit. ~~may assume other obligations that are included in the variable component of the Contract Termination Charge. NEP reserves its right to revise the variable cost estimates and the amortization of fixed cost components in Schedule 1 to reflect the assignment of obligations to the purchasers, if such revision is necessary to maintain a stable and declining pattern of Contract Termination Charges as offset by the Residual Value Credit.~~

[22]The $85 million represents total costs of $91 million less $6 million of FAS 106 transition obligation which is being recovered under Section 1.1.3.

[23]~~If NEP sells its non-nuclear generating facilities in more than one transaction, the revenues lost shall be allocated based on the kilowatthours generated by the unit sold to total kilowatthours generated from NEP's non-nuclear generating facilities during the period between the Retail Access Date and The Divestiture Date.~~

wholesale rate, if any, had it continued to make the sales to Mass. Electric under Tariff 1 and the revenues, excluding transmission revenues and Contract Termination Charge revenues, that it actually collected from sales to Mass. Electric's customers during the period, together with a credit for Mass. Electric's share of the revenue from sales at no less than market prices made by NEP to third parties during the period, provided, however, the lost revenues so calculated shall not exceed $0.008 per kilowatthour multiplied by the number of kilowatthours delivered by Mass. Electric during the period between the Retail Access Date and the Divestiture Date. If the Divestiture Date occurs after January 1, 1999, NEP shall provide a report to the Commission and the Signatories setting forth the reasons for the delay, and demonstrating its reasonableness, less

(iii) Mass. Electric's 72.6 percent allocated share of capital investments demonstrated to be prudently incurred after December 31, 1995, excluded from the plant balances in Section 1.1.1 (a) above,[24] less

[24]NEP's capital investments shall include construction work in progress. The investments in non-nuclear generating facilities in 1996 are shown in Schedule 4. These projects have been reviewed by the parties and are included as an offset to the Residual Value Credit subject only to a further review for the reasonableness of the amounts expended in the construction of the projects under Section 3.5 of the

(continued...)

(iv) Mass. Electric's 72.6 percent allocated share of reasonable transaction costs associated with the divestiture including the cost of refinancings, repurchases, and retirements of securities occurring after March 20, 1997, in excess of $20 million to NEP.

As shown in Schedule 1, page 2, The Net Proceeds from the divestiture including amortization and the pretax return specified in Section 1.1.2 on the unreturned credit balance net of tax impacts ~~shall be~~ has been credited to the Fixed Component in equal ~~annual~~ monthly amounts over the period commencing on the ~~date the Residual Value Credit is implemented~~ Divestiture Date and continuing through December 31, ~~2009~~2000. The Residual Value Credit shall be implemented even if: (i) the Divestiture Date occurs before the Retail Access Date, in which event Mass. Electric shall implement the Wholesale Access Date in accordance with Section 6.1.1, n. 3 of the Agreement, or (ii) the Residual Value Credit exceeds the Contract Termination Charge in any given year. ~~If the sale of assets, whose costs have been included in the Contract Termination Charge, occurs after December 31, 2009, NEP shall implement a Residual Value Credit following that date to amortize~~

[24](...continued)
Agreement. NEP may include additional projects, if any, ~~at the time of the calculation of the Residual Value Credit,~~ as of the Divestiture Date in the reconciliation to be made on the Reconciliation Date subject to the dispute resolution procedures under Section 3.5 of the Agreement.

~~the proceeds, with the return specified above, over no more than five years.~~

(e) Effective with refinancings, repurchases, and retirements of securities on and after March 20, 1997, NEP shall on the Reconciliation Date, for all purposes associated with the implementation of the Contract Termination Charge or the Residual Value Credit, flow through the ~~Residual Value Credit~~ Reconciliation Account the annual effects associated with any differences between NEP's 11.18 percent overall pre-tax return and the actual pre-tax return, calculated using a 9.4 percent return on common equity, attributable to changes in the cost of debt, preferred stock, capital structure or income tax rates, provided that the overall pre-tax return shall not exceed 11.18 percent so long as the yield on 10-year Treasury constant maturities as reported in the Federal Reserve Statistical Release is 9 percent or lower. In the event that the yield on Treasury maturities as so reported exceeds 9 percent, the 11.18 percent overall pre-tax return shall be adjusted to include NEP's actual cost of debt and preferred stock using a 9.4 percent return on common equity. This reconciliation will apply to the period following the Divestiture Date whether or not securitization has been implemented. Notwithstanding the foregoing, nothing shall require a change in capital structure prior to any financing to take advantage of securitization.

NEP shall not be required to implement securitization unless implementation would produce net savings after taking into account all transaction costs including call provisions and prepayments, if applicable.

Any and all financing savings associated with refinancing following divestiture or securitization shall be allocated to the Contract Termination Charge through this paragraph, and shall not be reflected in NEP's capital structure used for transmission rates. To the extent any financing savings are allocated to transmission rates by the Commission, however, they shall not also be allocated to the Contract Termination Charge under this paragraph.

1.2 The Variable Component of the Contract Termination Charge shall include Mass. Electric's allocated share of the items specified in Section 1.2.3, below adjusted for the Reconciliation Account discussed in Sections 1.2.1 and 1.2.2, below.

1.2.1 The Variable Component shall be adjusted through a Reconciliation Adjustment in which differences, whether positive or negative, between the estimates for Contract Termination Charge Payments by Mass. Electric and Mass. Electric's allocated share of the estimated variable costs listed in Section 1.2.3 below and actual Contract Termination Charge payments by Mass. Electric and its allocated share of the actual variable costs will be accumulated in a Reconciliation Account and added to or subtracted from the Contract Termination Charge from NEP to Mass. Electric. The Reconciliation Account shall also include the adjustments if any under Section 1.1.4~~(a)~~ above, caused by (i) a ~~deferral~~ change in the ~~Contract Termination~~ Divestiture Date, (ii) any other revisions to the Fixed Component associated with the reconciliations, adjustments, or true-ups that are completed on or after the Reconciliation Date, (iii) future sales of property or leases of nuclear entitlements, and (iv) changes in cost of capital. A pretax return equal to that specified in Section 1.1.2 shall be included on any balance in the Reconciliation Account, whether positive or negative.

The Reconciliation Account shall accumulate ~~through December 31, 2000,~~ each year and shall be used to adjust NEP's Base Contract Termination Charges to Mass. Electric ~~on~~ in the following year~~January 1, 2001~~. Thus, ~~effective January 1, 2001,~~ NEP shall return or collect Mass. Electric's allocated share of any outstanding balance in the Reconciliation Account by implementing an adjustment to the ~~Base~~ Contract Termination Charges to Mass. Electric in the following year. ~~Thereafter, the balance including the accumulated return in the Reconciliation Account at the end of a year shall be used to adjust NEP's Base Contract Termination Charges for the following year.~~ Reconciliation Account adjustments to the Contract Termination Charges shall not cause the Contract Termination Charges to exceed 2.8 cents per kilowatthour. Any deferrals caused by the limitation in the prior sentence shall be carried forward with a return into the next annual adjustment to the ~~Base~~ Contract Termination Charge. ~~Any Reconciliation Account adjustments occurring prior to January 1, 2001 that would otherwise cause the Contract Termination Charge to increase or decrease by more than 0.2 cent per kilowatthour shall be amortized with a return over the three years following January 1, 2001.~~

1.2.2 Through December 31, 2009, the Reconciliation Account ~~shall also~~ includes a Termination Charge Mitigation Incentive which ~~shall~~ increases the Variable Cost Component ~~when~~ because NEP has mitigated~~s~~ the Contract Termination Charge and reduced~~s~~ the estimated cumulative average of the cents per kilowatthour Contract Termination Charge to Mass. Electric below 2.8 cents per kilowatthour. The schedule of rewards for each level of the cumulative average Contract Termination Charge in each year from 1998 ~~2001~~ through 2009 is shown on Schedule 1, page 4.

1.2.3 Mass. Electric's 72.6 percent allocated share of the specific cost items included in the Variable Component are set forth in Schedule 1 at page 3. The difference between Mass. Electric's 72.6 percent allocated share of the actual variable costs incurred by NEP and the estimated variable costs in this section shall be included in the Reconciliation Account. The costs included in the Variable Component shall include the following:

(a) <u>Nuclear Decommissioning and Other Post Shutdown Costs</u> shown in Schedule 1, Pages 7 and 8, shall include: (i) all charges, excluding any net incremental decommissioning costs caused by operations after the Retail Access Date, for decommissioning and site restoration assessed to NEP by the operators of each nuclear electric generating facility specified in Section 1.1.1(a) (v), (vi) and (vii) above, subject to the regulatory authority of the agencies having jurisdiction over the operation and collection of such funds, (ii) all other reasonable post shutdown costs associated with NEP's entitlements in the units listed in Section 1.1.1(a)(v),

(vi) and (vii) above; and (iii) all remaining reasonable costs, including decommissioning costs and unrecovered capital costs, associated with Yankee Rowe, ~~and~~ Connecticut Yankee, and Maine Yankee shown on Schedule 1, page 8. Funding for the decommissioning costs will be placed in irrevocable trusts in accordance with NRC regulations. If, upon the completion of decommissioning for any of the above listed nuclear generating facilities, it is determined that there has been an over collection of funds, such over collection will be transferred to NEP's decommissioning fund for either Millstone 3 or Seabrook 1 pending final disposition of their decommissioning. Once all decommissioning is complete, any over collection will be refunded to Mass. Electric in the Reconciliation Adjustment. Other post shutdown costs will also be fully reconciled in the Reconciliation Adjustment.

(b) Power Contract Payments~~Above Market Payments to Power Suppliers~~ will be (i) all payments by NEP for Long-Term Power Supply Contracts less the ~~market value realized~~ payments received from the Buyer or from resale of electricity purchased under the contracts into the wholesale market which are as shown on Schedule 1, plus (ii) Economic Buyout Payments associated with those contracts, less (iii) Credit for Unit Sales Contracts.

(i) Long-Term Power Supply Contracts will be all power supply contracts in place as of December 31, 1995, between NEP and a third party supplier, continuing to the termination date of each contract. The Long-Term Supply Contracts include:

(1) Ocean State Power

(2) Canal
(3) NU Slice
(4) Lawrence Hydro
(5) Mascoma Hydro
(6) Pontook Hydro
(7) Northeast Landfill
(8) Turnkey
(9) Ogden Haverhill
(10) RESCO Saugus
(11) RESCO N. Andover
(12) Signal - Millbury
(13) Hydro MWRA
(14) RFA Lawrence
(15) ALTRESCO
(16) Clark University
(17) Milford Power
(18) Pawtucket
(19) Barre Landfill
(20) Nashua Landfill
(21) Hydro Quebec

(ii) Economic Buyout Payments will be ~~all reasonable payments~~ the trigger payments agreed to by NEP ~~after April 1, 1997~~under Section 8(d) of the PPA Transfer Agreement, associated with the ~~sale, assignment,~~ disposition~~, or buy down~~ of the Long-Term Power Supply Contracts. Economic Buyout Payments shall be recovered as incurred to the extent that current recovery does not increase rates to customers above the level that would have been incurred absent the ~~sale, assignment,~~ disposition~~, or buy down~~ of the

Long-Term Power Supply Contract. The portion of the Economic Buyout Payment that cannot be recovered currently under the prior sentence shall be deferred and recovered with the return specified in Section 1.1.2 as soon as such recovery will not increase rates to customers above the level that would have been incurred absent the sale, assignment, disposition, or buy down of the Long-Term Power Supply Contract. ~~If the Contract Termination Date has not yet occurred at the time that an Economic Buyout Payment is made, the schedule of recovery set forth in the prior two sentences shall be applied to NEP's Tariff No. 1 fuel clause to Mass. Electric so that NEP fully recovers Mass. Electric's allocated share of the Economic Buyout Payment from Mass. Electric.~~

(iii) Credit for Unit Sales Contracts will be all unit sales contracts entered into by NEP as of December 31, 1995, for sales from the following generating units if they are not otherwise subject to market valuation less the market value of these contracts as shown in Schedule 1, Page 3, Columns (7) through (9). Units Sales Contracts include contracts for NEP's sale of power from the following units:

~~(1) Ocean State Power~~
(1~~2~~) Maine Yankee
(2~~3~~) Millstone 3

(3~~4~~) Seabrook I

~~(c) Above Market Fuel Transportation as shown in Schedule 1, Page 12, will be the sum of NEP's continuing long-term payment obligations associated with (i) Capacity Payments to Interstate Natural Gas Pipelines less the market value of that capacity, and (ii) Coal Ship Obligations less the Market Value associated with those obligations (see Schedule 1, page 12).~~

~~(i) Capacity Payments to Interstate Natural Gas Pipelines will be all capacity payments for Interstate Pipeline Capacity Contracts in effect as of December 31, 1995. They include:~~

~~(1) NOVA~~
~~(2) TCPL~~
~~(3) Iroquois~~
~~(4) Tennessee~~
~~(5) Algonquin~~
~~(6) ANR~~
~~(7) Columbia~~
~~(8) Distrigas~~
~~(9) Providence Gas~~
~~(10) Brayton Point Lateral~~

~~The Market Value of Capacity Payments to Interstate Natural Gas Pipelines will equal the actual proceeds associated with the sale or assignment or termination of contractual obligations. For the purposes of calculating the Base Contract Termination Charges prior to the date that NEP's contractual entitlements to the pipeline capacity are assigned to a non-affiliate, the Market Value of Capacity Payments to Interstate Natural~~

~~Gas Pipelines shall be deemed to equal the amounts shown on page 12 of Schedule 1, which are 50 percent of such capacity payments.~~

~~(ii) Coal Ship Obligations will be all payments by NEP under its charter with the Energy Enterprise until the contract is otherwise terminated or assigned. The market value of these Coal Ship Obligations will equal the actual proceeds associated with the assignment or termination of the charter with the Energy Enterprise, and are assumed to be zero for the purpose of calculating the Base Contract Termination Charges and the estimate included in the Reconciliation Account. See Schedule 1, page 12.~~

(d) (i) Transmission wheeling charges for the units sold to the Buyer or for the contracts set forth in Section 1.2.3(b) to the extent the transmission wheeling charges exceed the charges that would be payable under NEP's proposed pricing policy that is incorporated in the Tariff No. 9 filing and Continuing Site/ Interconnection Agreement filed by NEP on October 1, 1997, and (ii) transmission wheeling charges as shown in Schedule 1, Page 3, associated with the transmission of electricity from NEP's entitlements in Connecticut Yankee, ~~Maine Yankee,~~ Millstone Unit 3, Wyman Unit 4, and Vermont Yankee, ~~and NEP's purchase from a slice of Northeast Utilities system,~~ which units are located off of NEP's transmission system, together with support payments to Central Maine Power and Connecticut Light and Power which are necessary for the transmission of NEP's remote generation. These wheeling and support payments shall include only costs that are excluded from recovery under NEP's and NEPOOL's open access transmission tariffs or are not assigned to a purchaser of the unit.

(e) Payments in Lieu of Property Taxes will include all reasonable costs incurred by NEP or its affiliates associated with payments in lieu of property taxes to the cities and towns in which NEP owns generating facilities to mitigate the loss of tax revenues that those cities and towns would otherwise incur in connection with restructuring. For the purposes of calculating the Base Contract Termination Charges and the estimate included in the Reconciling Account, the Payments in Lieu of Property Taxes are assumed to be zero.

(f) Employee Severance and Retraining as shown in Schedule 1, page 3, Column (13), will include all reasonable costs and expenses incurred by NEP or its affiliates associated with the adjustment of their workforces in connection with the implementation of retail access, divestiture, or the termination of NEP's Tariff No 1, including, but not limited to early retirement, severance, retraining and other reasonable costs associated with the implementation of the benefits to employees included in Schedule 5. NEP shall require purchasers of its generating business to pay $85 million for the costs under this paragraph incurred by NEP and its affiliates. In the event that the actual costs incurred by NEP and its affiliates under this paragraph are less than $85 million, excluding costs found by the

Commission to be recoverable in NEP's transmission rates, NEP shall flow back the difference to customers in the Reconciliation Account. The procedure established in this paragraph shall be the exclusive method for recovering the costs under this paragraph, and, except in the event of legislation changing required benefits, neither NEP nor its affiliates shall be able to recover more than $85 million for these costs. Thus, for the purposes of calculating the Base Contract Termination Charges and the estimate included in the Reconciliation Account, the Employee Severance and Retraining Costs are assumed to be zero and, except in the event of legislation changing required benefits, these costs shall not result in an increase to the Reconciliation Account or to the Contract Termination Charge.

(g) Damages, Costs, or Net Recoveries from claims by or against third parties shall include all damages, costs, or recoveries associated with NEP's generating business which accrued prior to the date of divestiture and which were not: (i) included in the reserves for generation related, uninsured claims other than claims associated with Environmental Response Costs as of January 1, 1995, plus annual additions to the reserves for uninsured claims in NEP's W-95(S) rate, less actual payments out of the reserve for generation related claims during the period from January 1, 1995 through the Contract Termination Date; (ii) assigned to NEP's successor in interest; (iii) recovered from NEP's insurance carriers; (iv) the result of gross negligence. For the purposes of calculating the Base

Contract Termination Charges and the estimate included in the Reconciliation Account, Damages, Costs, or Net Recoveries from claims were assumed to be zero.

(h) Performance Based Rate for Nuclear Units Remaining After Divestiture shall credit value received that is not otherwise reflected in the Residual Value Credit, or recover any payments or costs associated with the sale, lease or disposal of nuclear units or entitlements that are not otherwise reflected in the Residual Value Credit. If NEP is unable to sell, lease, assign, or otherwise dispose of its nuclear units or entitlements on the terms set forth in the Agreement prior to the Contract Termination Date, the Performance Based Rate shall include 80 percent of the reasonable going forward costs, including variable costs and capital additions, on a cost of service basis[25] associated with NEP's nuclear units or entitlements that are not otherwise recovered in contract termination charges less 80 percent of the revenues from sales of energy or capacity from such units or entitlements that are not otherwise reflected in contract termination charges. The Performance Based Rate shall apply for the period from the Contract Termination Date to the date that NEP either sells, leases, assigns or otherwise disposes of the nuclear unit or entitlement of the nuclear unit is shutdown. Within six months prior to implementing the Performance Based Rate, NEP will consult with the Signatories on a

[25]In the event that the nuclear unit is retired before the end of its license life, the capital addition shall be amortized with a return over the remainder of the license or in accordance with its depreciation schedule, whichever is shorter.

performance standard for nuclear safety indicators and will file such performance standard with a maximum potential credit for non-performance of $1 million. Such sales, if any, shall only be made in the wholesale market to non-affiliates provided, however, that NEP shall retain the right to use its minority shares of the units or entitlements to fulfill its minimum, zero bid obligations under the standard offer. For the purpose of calculating the Base Contract Termination Charges and the estimate included in the Reconciliation Account, the Performance Based Rate for Nuclear Units is assumed to be zero.

(i) Environmental Response Costs defined as:

(i) Reasonable and prudently incurred costs associated with the investigation, testing, remediation, liabilities, damages, claims, settlements, or judgments attributable to or incurred by NEP or Narragansett relating to deposits or waste from divested generating facilities off the site of properties sold, whether or not such material is regulated under the statutes and authorities referenced in paragraph (iv), including material deposited before the Divestiture Date at disposal sites, sites to which material may have migrated from off-site disposal sites, or any off-site location at which generation related material may have been deposited before the Divestiture Date associated with the operation of generating facilities sold pursuant to the divestiture plan;

(ii) Reasonable and prudently incurred costs associated with the investigation, testing, remediation, liabilities, damages, claims, settlements, or judgments attributable to or incurred by NEP or Narragansett relating to deposits and wastes occurring prior to the Divestiture Date whether or not such material is regulated under the statutes and authorities referenced in paragraph (iv) from facilities located either within the switchyards for which NEP will retain a permanent easement on parcels that are otherwise being divested or the Brayton Point step-up transformers if such costs are not recovered in transmission rates;

(iii) Reasonable and prudently incurred costs associated with the purchase of property that is acquired as part of an overall mitigation and response plan associated with sites identified in paragraphs (i) and (ii);

(iv) The statutes and authorities referenced in paragraphs (i) and (ii) shall be the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), Resource Conservation and Recovery Act (RCRA), Massachusetts G.L. c. 21C and 21E, and Rhode Island General Laws 23-19.14, or any other laws, regulations or orders by courts or governmental authorities, or resulting from claims and contentions arising in tort, breach of contract or violation of law;

(v) Except for property acquired under paragraph (iii), Environmental Response Costs shall not include costs associated with the investigation, testing, remediation, or other liabilities relating to property acquired after the Divestiture Date. Environmental Response Costs recovered under paragraphs (i), (ii), and (iii) shall also be offset by: (i) reserves related to Environmental Response Costs as of January 1, 1995, less actual payments out of the Reserve for Environmental Response Costs during the period from January 1, 1995 through the Contract Termination Date; (ii) proceeds from insurance companies related to Environmental Response Costs; (iii) proceeds from the sale of properties purchased under paragraph (iii); and (iv) recoveries from third parties;

(vi) Nothing herein is intended to limit, alter, or otherwise affect any liability of NEP to governmental authorities or third parties other than the buyer or buyers of NEP generating facilities under any environmental law including those referenced in paragraph (iv).